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Supreme Court of the United States

OCTOBER TERM, 1962

No. 70

IRVING J. WOLF, ROBERT H. DAVIDSON, RICHARD S. HULL and FREDERICK KATZENELL,

Petitioners,

against

ARNOLD A. WEINSTEIN, JEROME FRIED, NAZARETH FAIRGROUNDS & FARMERS' MARKET, INC., *et al.*,

Respondents.

IN THE MATTER

of

NAZARETH FAIRGROUNDS & FARMERS' MARKET, INC.,

Debtor

In Proceedings for the Reorganization of a Corporation, Two Cases (No. 26362 and No. 27000)

BRIEF FOR RESPONDENT JEROME FRIED ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

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The Supreme Court has granted certiorari to the Court of Appeals for the Second Circuit in two cases, one numbered 26,362 in that Court and the other 27,000. These cases are entirely separate, presenting no common issue of law or fact. They are related only in that they arise in the same corporate reorganization proceeding in the Bankruptcy Court. Accordingly, they are briefed separately herein.

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BRIEF FOR RESPONDENT JEROME FRIED ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

CASE ONE

(No. 26362)

Statutes Involved.

Sections 189 and 191 in Article VIII, and all of Article XIII (§§241-250) of the Bankruptcy Act are set forth in the appendix.

Question Presented.

Does §249 of the Bankruptcy Act, which requires applicants for compensation or reimbursement of expenses to file a statement under oath as to trading in the corporation's stock, and denies compensation or reimbursement to applicants who have bought or sold the Debtor's stock during the pendency of the proceeding, apply to one who is employed by the Debtor-in-Possession in a managerial capacity on a weekly salary and is not an applicant for compensation or reimbursement under Article XIII?

Statement of the Case.*

Jerome Fried was manager of Nazareth Fairgrounds & Farmers' Market, Inc. before the institution of the Chapter X Proceeding [R 45]. When the proceeding was commenced, his employment was continued by court order under the mistaken impression that he was secretary and treasurer of the corporation [R 17]*. Subsequent orders increased his weekly salary as "manager" from $50 to $150 [R 21-2] and to $200 [R 38-9].

Fried's duties consisted of: the collection of rents from the several tenants of the market; the arrangement of joint advertisement of the tenants' wares; preliminary negotiations for the renting of space in the market; general superintendence, seeing that the premises were kept in a clean and proper condition. He signed no leases, contracts or documents binding the Debtor; signed no checks. All matters of importance, including the making of the leases, were referred to Weinstein, the president [R 485-9].

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* For an employee, as Fried was, such an order was unnecessary. *In re Wil-Low Cafeterias* (2 C. A. 1940) 111 F. 2d 429, 431.

The Court of Appeals found:

> "The administration has been successful, gross business having tripled from 1953 to 1959 and profits having arisen from zero to $41,269." [R 575].

Fried has made no application for allowance and has never signed any petition or affidavit in connection either with his original employment and salary, or with any subsequent employment or increase in salary.

The District Court discharged Fried and terminated his compensation "solely because [he] had violated §249 of the Bankruptcy Act by trading in the Debtor's stock and upon no other basis" [R 249]. The Court of Appeals made it clear that neither it nor the Court below was dealing "with breaches of fiduciary obligation"; that the Court below had not exercised discretion:

> "The distinction is that such a ruling would rest upon an exercise of judicial discretion, taking appropriate account of all relevant circumstances, rather than on the automatic forfeiture which the judge here thought the statute required." [R 581].

Pertinent Statute.

"Sec. 249. Any persons seeking compensation for services rendered or reimbursement for costs and expenses incurred in a proceeding under this chapter shall file with the court a statement under oath showing the claims against, or stock of, the debtor, if any, in which a beneficial interest, direct or indirect, has been acquired or transferred by him or for his account, after the commencement of such proceeding. No compensation or reimbursement shall be allowed to any committee or attorney, or other person acting in the proceedings in a representative or fiduciary capacity, who at any time after assuming to act in such capacity has purchased or sold such claims or stock,

or by whom or for whose account such claims or stock have, without the prior consent or subsequent approval of the judge, been otherwise acquired or transferred."

Summary of Argument.

The provision of §249, which bars from allowances in corporate reorganization proceedings applicants who have traded in the corporation's stock during the course of the proceeding, does not extend beyond the boundaries of Article XIII. The compensation not to be "allowed" to applicants under that section is the same "allowance" for which a hearing and notice to all persons in interest is required by §247.

A salaried employee who is hired as incidental to the operation of the business and management of the property of the Debtor under §189, is not a person acting in a "fiduciary capacity" under §249. §249 denies compensation because of stock trading "to any committee or attorney, or other person acting in the proceedings in a representative or fiduciary capacity". The word "fiduciary", which is a word of uncertain content, readily takes its meaning from its associates. Thus, while the section has often been applied to committee representatives and to attorneys, it has never been applied to a salaried employee. It is the persons who are brought in for the reorganization and who will have a voice in the plan finally to emerge that §249 applies, and not to salaried employees, no matter how important their ministerial functions are to the corporation.

The distinction is between applicants for the Court's grace whose compensation is dependent upon whether they benefited the estate on the one hand, and servants whose compensation is dependent upon the contract of employment on the other.

The application of §249 to employees, even those of managerial rank (especially if the corporation is a large one), is wholly impracticable. The filing in court of a statement under oath showing no trading in the stock under §249, and notice and hearing, which §247 requires, could not possibly fit in with the orderly conduct of the Debtor's business. Moreover, strict construction is called for in the case of a penal statute, which experience has shown to be unduly harsh, and which is in derogation of the common law.

The contention that the Court in its discretion should discharge Fried for misconduct raises a feigned issue. The question of misconduct was litigated in a parallel controversy, now finally decided adversely to petitioners.* Review of that question was not sought of this Court, and time to do so has long since expired.

POINT I.

Section 249 may not be construed to cover a salaried employee.

A. The job of manager-employee is not included in the description of persons subject to §249.

(1) Certainly the statute does not say "employee", "manager", "agent" or even "officer". The persons covered are described as a "committee or attorney, or other person acting in the proceedings in a representative or fiduciary capacity"**. The only word upon which an argument can be based to include Fried is "fiduciary". But

* *Wolf* v. *Nazareth Enterprises, Inc. et al* (2 C. A. May 4, 1962) 303 Fed. 2d 152.

** When petitioners quote the statute (Brief, 4, 133), they omit the words "committee or attorney, or other", obviously to avoid *noscitur a sociis* and thereby stretch the statute.

"fiduciary" is a chameleon, which easily takes its color from its background.

To quote Mr. Justice Frankfurter in *SEC* v. *Chenery Corp.* (1943) 318 U. S. 80, 85-6:

> "But to say that a man is a fiduciary only begins analysis; it gives direction to further inquiry. To whom is he a fiduciary? What obligations does he owe as a fiduciary? In what respect has he failed to discharge these obligations? And what are the consequences of his deviation from duty?"

Here, Fried was a fiduciary only in the loose, general sense that every agent is such. The "fiduciary" mentioned in the statute is manifestly of the type that goes with the other appellations used.

Fried was not a "committee or attorney". He represented no one. Whether he was in a "fiduciary capacity" within the meaning of §249 manifestly depends, not on whether he held a position of dignity and importance in the operation of the business, but on whether he acted in a fiduciary capacity "in the proceedings", which must mean in matters directly affecting the plan of reorganization.

With respect to §243, a neighbor of §249 in Article XIII, it was said, per Hamilton, C. J., in *Gochenour* v. *Cleveland Terminals Bldg. Co.* (6 C. A. 1944) 142 F. 2d 991, 995, cert. den. 323 U. S. 767:

> "This section of the Act relates entirely to matters in connection with the reorganization of the debtor and proceedings on behalf of creditors and stockholders. It comprehends matters directly affecting the plan of reorganization and excludes those indirectly affecting it."

Fried had nothing whatever to do with the reorganization, and was in no position to formulate a plan or to participate in its formulation.

(2) Nor is Fried properly described as an "insider". While, as the collector of rents and manager of the property he would, no doubt, have information as to the receipts and disbursements of the Debtor with respect to the property, this is the same information which anyone could have by inspecting the monthly statements filed under the order of the Court [R 17-18].

(3) There is nothing to indicate that §249 was meant to apply to the day-to-day activities of an employee of the Debtor-in-Possession. In practically every case where a Debtor is continued as Debtor-in-Possession the business, of necessity, is operated by employees and officers who are continued on a salaried basis. Yet no reported case has come to hand in which any court has applied §249 to such employees or officers, or, indeed, to any other than committeemen or other representatives of security holders, or to the attorneys for them or for the Debtor. In the lone case in which it was sought to apply the statute to a trust company that had acted as a depositary for assents to the plan of reorganization, the Court refused to apply the bar upon the ground that the depositary's duties were administrative in nature. *In re Brown Co.* (D. Me. 1941) 36 F. Supp. 275, 277. *A fortiori* §249 cannot be applied to a working manager who has nothing to do with the reorganization process. It is manifest that §249 was intended to apply only to those persons who in a fiduciary capacity could influence the plan of reorganization finally to emerge.

B. The location of §249 in Article XIII of the Act indicates its limitation to applicants for allowances in the reorganization proceeding.

(1) The Debtor-in-Possession was empowered to continue Fried's employment under the authorization to operate the business and manage the property under §189

of the Bankruptcy Act. While the Debtor-in-Possession went through the form of obtaining the approval of the Court, as in the case of an officer under §191, this was not necessary. *In re Wil-Low Cafeterias* (2 C. A. 1940) 111 F. 2d 429, 431; *In re Avorn Dress Co., Inc.* (2 C. A. 1935) 78 F. 2d 681, 683.

Fried did not apply for the original order of employment or for the subsequent orders increasing his compensation. Fried is not now, and never has been an applicant for compensation from the Court.

(2) §249 is found in Article XIII of the Bankruptcy Act, entitled "Compensation and Allowances". Article XIII is a complete whole, dealing with the applications for, and the granting of allowances to those functionaries who must look to the Court for an allowance intermediate their service, or at its end. With the possible exception of the indenture trustee, all of the persons mentioned in the article belong to the group who are strangers to the Debtor until the proceedings are initiated, and who will have nothing to do with the Debtor after the plan has been confirmed. There is the referee, special master, trustee, other court officers, the attorneys for any of them, the attorney for the Debtor or for the petitioning creditors, the depositaries, reorganization managers, committees or representatives of creditors or stockholders, and their agents and attorneys. True, there is provision for "other parties in interest except the Securities and Exchange Commission", but the functions of the persons who are specified are such as to indicate that the entire article relates to the reorganization crew and not to the continuing employees of the Debtor.

§249 fits like a glove the sections which precede it in Article XIII. By §249 no compensation or reimbursement

shall be "allowed" if the applicant has traded in stock. The word "allowed" appears in §248, and the word "allow" in each of §§241, 242, 243, 244, 245 and 246. §§247, 248 and 250 speak of "allowances". "Allowed" and "allow" are verbal forms, and "allowances" is the noun. Manifestly, the applications dealt with under §249 are for the same "allowances" for which notice and a hearing are required under §247. On the other hand, it was a salary that was being paid to Fried [R 24, 29, 39]. Nowhere in Article XIII is there any mention of "salary".*

According to Black's Law Dictionary (p. 97):

> "*Allowance.*
>
> * * * * * *
>
> "As distingished from a 'salary,' which is a fixed compensation, decreed by authority and for permanence, and is paid at stated intervals, and depends upon time, and not the amount of the services rendered, 'allowance' is a variable quantity."

This Court has said in *Benedict* v. *United States* (1900) 176 U. S. 357, 360:

> "The word 'salary' may be defined generally as a fixed annual or periodical payment for services, depending upon the time and not upon the amount of services rendered."

(3) Petitioners argue [Brief 153] that Article XIII is not self-contained. They say that reference must be had to §221(4) which provides that the judge may confirm a plan if satisfied that payments made or promised for services in connection with the proceeding are "reasonable". This Court, they say, has said that "reasonable" in that section

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* For the distinction between salary and allowance see *Mangam* v. *The City of Brooklyn* (1885) 98 N. Y. 585, 598.

"necessarily implies loyal and disinterested service in the interest of those for whom the claimant purported to act."* But Article XIII in each of §§241, 242, 243, 244 and 245 provides that the compensation must be "reasonable". There is no reason why this use of "reasonable" should not also imply loyal and disinterested service. Furthermore, §221(4) relates, not to allowances by the Court, but to payments or promises made by others, and not originating with the Court. Thus, the case petitioners cite** is one in which attorneys were endeavoring to enforce a promise for compensation made to them by the committee of security holders that they represented. It could not have been the Congressional intent that the judge, having fixed an allowance as reasonable under Article XIII before confirmation of the plan, should turn his cap about and, in an appellate capacity, now determine that the compensation he had previously fixed, and which may already have been paid, was reasonable or unreasonable. In other words, there is no reason to go outside of Article XIII upon any question relating to the applications of the various reorganizers for compensation. Yet petitioners have ripped this §249 from its setting in Article XIII and are attempting to apply it to the employment of personnel by the Debtor or Debtor-in-Possession to which it obviously bears no relation.

(4) Petitioners argue [Brief 152] that the location of §249 in Article XIII should be disregarded for purposes of construction because of an appended provision in the Act of June 22, 1938, which put the Bankruptcy (Chandler) Act into effect. It reads:

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* *Woods* v. *City Bank Co.* (1941) 312 U. S. 262, 268.

** *Leiman* v. *Guttman* (1949) 336 U. S. 1.

> "b. Sections and subdivision headings shall not be taken to govern or limit the scope of the sections or subdivisions to which they relate."

This has no bearing. Respondent does not rely upon any section or subdivision heading, but upon the entire scheme and plan of the Bankruptcy Act, and particularly upon the pattern of Article XIII.

C. The contractual relation of employees to the Debtor sets them off from applicants to the Court for an allowance.

(1) Employees of the Debtor or Debtor-in-Possession stand in an entirely different position to the Debtor from the persons covered by §249. In one case, the relationship is contractual; in the other, there is no contract, and compensation depends on benefit to the estate as determined in the Court's discretion. No doubt the Debtor's payroll is subject to the Court's direction, and the Court could step in at any time and increase or decrease the salary of any employee for the future. By the same token the employee, if dissatisfied, could resign and seek employment elsewhere.

Applicants for an allowance stand on an entirely different footing. They have no contractual claim against the Debtor. Their application is based on benefit to the estate.

By §243:

> "In fixing any such allowances, the judge shall give consideration only to the services which contributed to the plan confirmed or to the refusal of confirmation of a plan, or which were beneficial in the administration of the estate, and to the proper costs and expenses incidental thereto."

Applicants for an allowance stand before the Court seeking its grace, and the Court, subject to appellate review, may in its discretion grant or refuse an allowance. In *Dick-*

inson Co. v. *Cowan* (1940) 309 U. S. 382, the Court said, per Douglas, J. (p. 389):

> "Fee claimants are either officers of the court or fiduciaries, such as members of committees, whose claims for allowance from the estate are based only on service rendered to and benefits received by the estate. Allowance or disallowance involves an exercise of sound discretion by the court based on that statutory standard."

An employee might turn in an indifferent performance and yet be entitled to his salary. As for an applicant for allowance, however, "Whether an application for an allowance be considered under section 242 or 243, administrative services must benefit the estate, if compensation is to be allowed." Swan, C. J. *In re Postal Telegraph & Cable Corporation* (2 C. A. 1941) 119 F. 2d 861, 862.

Petitioners picture Fried as an applicant for an allowance who is privileged to receive his compensation weekly instead of having to wait until the conclusion of the case. This wholly ignores the distinction between those working on contract on the one hand, and those working in anticipation of an allowance on the other. It would be a quaint conception that all employees of a Debtor-in-Possession are merely applicants for allowance under §249, and that the weekly stipends that they receive are to be regarded merely as tentative advances subject to refund.

(2) Petitioners seek to break down this obvious distinction. They assert [Brief 156] "Except the trustee, the additional trustee, the trustee's attorney, and the examiner, virtually every other person serving in the proceedings, and looking to the estate for compensation, is appointed and compensated by 'consensual arrangements' with his respec-

tive clients". The exception comes near swallowing the proposition asserted. However, while the appointment (as that of attorneys, for example) may be initiated by consensual arrangement, the compensation is never a matter of "consensual arrangement". In *Leiman* v. *Guttman* (1949) 336 U. S. 1, which petitioners cite, it was expressly held that the attorneys for a securities' committee were not entitled to shares that had been set aside as their compensation by agreement with the committee, but must look to the District Court for an allowance.

D. The procedural requirements for an allowance do not permit the extension of Section 249 to salaried employees.

(1) If §249 is to be applied to an employee of a Debtor-in-Possession, must it not also be applied to an employee of a Debtor not in possession, since his compensation also comes out of the estate? If it is to be applied to an employee of managerial rank, how far down the scale does the section reach? Assuming one of our large corporations with hundreds of managerial employees in its various branches and factories was being reorganized under Chapter X, would it apply to all of these?

The section requires that an applicant for an allowance "shall file with the court a statement under oath showing the claims against, or stock of, the debtor, if any, in which a beneficial interest, direct or indirect, has been acquired or transferred by him or for his account, after the commencement of such proceeding". Must all employees, before receiving each weekly salary check, file such a statement under oath, and not with the employer, but with the court?

(2) Petitioners [Brief, 153-4] would solve this dilemma by having the employee file such a statement before he

received any salary at all; "additional statements need be filed only when new circumstances require new disclosures". Such a system would work if the employee were to be compensated only if he had traded in the stock. But, since a negative is required before compensation can be allowed, it is difficult to see how, under the command of the statute, the weekly statement could be dispensed with.

Petitioners go so far (Brief, 153) as to suggest that the second part of the section is the important part, and that the first part, requiring the statement under oath, can be disregarded. The fact, however, that the statute does require the filing of such a statement before an allowance can be granted, argues strongly that Congress in this section was dealing only with the usual application for an allowance and the papers in its support.

(3) Petitioners construe the statute, not only as requiring the discharge of the employee and the withholding from him of any pay, future or in arrears, but also the restitution by him of all wages previously paid him. The very extremes to which petitioners' logic carries their interpretation of the statute is persuasive that their construction is not a sensible one. Such an interpretation would so amend the statute that its own draftsman could not recognize it. It would mean that every employee who, or whose wife,* has purchased a share of stock at any time during the course of the reorganization would be subject to automatic discharge and forfeiture of all wages previously earned and paid.

(4) Finally §249 cannot apply to the salary of an employee unless it is compensation "allowed" under the

* Cf. *In re Midland United Co.* (3 C. A. 1947) 159 F. 2d 340; *Berner v. Equitable Office Bldg. Corp.* (2 C. A. 1949) 175 F. 2d 218.

language of that section. But by §247 the judge must fix "a time of hearing for the consideration of applications for allowances" and notice must be given to creditors, stockholders, the Securities and Exchange Commission and other persons designated by that section. Thus, if §249 is to be applied to a salaried employee, such hearing and notice must precede the weekly paycheck. In the case of Fried, 485 such hearings would have been required.

POINT III.

Since it is a penal statute in derogation of the common law and unduly harsh in its operation, Section 249 should be strictly construed.

A. Section 249 alters pre-existing law.

This Court has, in effect, so held. In *SEC* v. *Chenery Corporation* (1943) 318 U. S. 80, a proceeding for the reorganization of a registered holding company under the Public Utility Holding Company Act of 1935, respondents, who were officers, directors and controlling stockholders, had purchased preferred stock of the corporation during the proceeding. The Commission had disapproved a plan of reorganization which would have permitted respondents to exchange the stock thus acquired for stock of the reorganized corporation on the same basis as other preferred stockholders, and had recommended a formula under which the stock so acquired by respondents should be surrendered for cost plus 4%. Such a plan was then proposed and approved by the Commission. The Court of Appeals set aside the Commission's order, and this Court remanded the case for further consideration pointing out that "there were no principles of law or equity which in themselves would be

sufficient to justify this order [of the Commission]"*. The Court said, per Mr. Justice Frankfurter (p. 88):

> "If, therefore, the rule applied by the Commission is to be judged solely on the basis of its adherence to principles of equity derived from judicial decisions, its order plainly cannot stand. As the Commission concedes here, the courts do not impose upon officers and directors of a corporation any fiduciary duty to its stockholders which precludes them, merely because they are officers and directors, from buying and selling the corporation's stock."

And again (p. 93):

> "Congress itself did not proscribe the respondents' purchases of preferred stock in Federal. Established judicial doctrines do not condemn these transactions."

To the same effect is *Manufacturers Trust Co.* v. *Becker* (1949) 338 U. S. 304.

Here is a statute, §249, which penalizes stock purchases by specified persons during the pendency of the Chapter X reorganization proceeding. Since this is a departure from "established judicial doctrines", the section is subject to strict construction. *Herd & Co.* v. *Krawill Machinery Corp.* (1959) 359 U. S. 297, 304-5; *Shaw* v. *Railroad Company* (1879) 101 U. S. 557, 565.

B. Section 249 is a penal statute.

(1) Certainly a statute imposes a penalty when the forfeiture exacted bears no relation to the damage sustained, and may even be incurred where there is no damage. *Hunt-*

* The quotation is from this Court's explanation of this decision in a subsequent decision (1947) 332 U. S. 194, 198, when the case was again before it.

ington v. *Attrill* (1892) 146 U. S. 657, 667, defines "penal" and "penalty" as "including any extraordinary liability to which the law subjects a wfongdoer in favor of the person wronged, not limited to the damages suffered". Thus, *Bolles* v. *Outing Co.* (1899) 175 U. S. 262, 264, in holding penal and, therefore, subject to strict construction, R. S. 4965, the forfeiture section under the Copyright Law, said (p. 264):

> "It makes no pretense of awarding damages, and simply imposes a forfeiture of a specified sum".

Under §249, the purchase of a single share during the proceeding may deprive the purchaser of compensation and out-of-pocket expenses amounting to thousands of dollars.

For the proposition that the statute is penal there is high authority.

Commissioner Douglas of the SEC thus testified before the House Committee on Judiciary on H. R. 6439, subsequently amended and reintroduced as H. R. 8046, 75th Congress, 1st Session (p. 183):

> "The Chandler bill makes further significant changes in that respect. On page 65 there is a very important provision, that those who have purchased or sold securities in contemplation of or after the commencement of the proceedings should not be allowed compensation or reimbursement from the estate. Now, this is a development of the idea that fiduciaries who trade in securities should be *penalized;* that is, where they act contrary to the spirit, at least, of the common law and, in certain types of transactions, contrary to the letter of the common law. Committees for example, have included in deposit agreements contract provisions designed to alter these common-law rules governing fiduciaries. And they have pretty well succeeded in doing so." [Emphasis added]

In *Silbiger* v. *Prudence Bonds Corporation* (2 C. A. 1950) 180 F. 2d 917, cert. den. 340 U. S. 813, Judge Learned Hand, in holding that the strictures of §249 did not apply to an attorney whose client had traded in the corporation's securities, four times characterized the forfeiture provision of §249 as a "penalty".

(2) Petitioners argue [Brief 148] that §249 is not penal, but remedial. For this they cite only *Adler* v. *Klawans* (2 C. A. 1959) 267 F. 2d 840, which deals with an entirely different statute, §16(b) of the Securities Exchange Act. There is conflict whether the provisions of that statute are remedial or punitive*. If §249 had provided for a recovery of the profits made upon the stock traded, either at the suit of the corporation or of a stockholder, the case cited might have application. Under §16(b) there is restitution to the other stockholders of profits from the forbidden transaction by their addition, when recovered, to the corporation's assets. But under §249 there is no element of restitution. For having dealt in the stock, the culprit is penalized, not to the extent of his profits, but in the entirely different field of reimbursement for expenses and compensation for services to the reorganization. Elsewhere petitioners say, perhaps unguardedly [Brief 151], that §249 has "the Congressional and judicial purpose of preventing and *penalizing* insider trading". This makes it unanimous.

To apply §249 to the salaried employee of a Debtor or Debtor-in-Possession "would do violence to the well estab-

* *See Commissioner* v. *Obear-Nester Glass Co.* (7 C. A. 1954) 217 F. 2d 56, cert. den. 348 U. S. 982, rehearing den. 349 U. S. 948; *General American Investors Co., Inc.* v. *Commissioner* (2 C. A. 1954) 211 F. 2d 522; aff'd 348 U. S. 434; *Smolowe* v. *Delendo Corporation* (2 C. A. 1943) 136 F. 2d 231, cert. den. 320 U. S. 751; and *Park & Tilford Distillers Corp.* v. *United States* (Ct. Cl. 1952) 107 F. Supp. 941, cert. den. 345 U. S. 917.

lished principle that penal statutes are to be construed strictly"*.

C. Section 249 works an excessively harsh result.

The Court below in this case characterized §249 as inflicting a "Draconian penalty". Judge Learned Hand called it "drastic"[1]. So did Judge Hincks, and he also called the case one of "hardship"[2]. Judge Dimock found the imposition of §249 "tragic"[3], and on appeal the Court noted that the result worked "harshly"[4]. The District Court below in this case considered Judge Dimock's use of the word "tragic" apt [R 480].

Frequently, when §249 has been applied, the Court has been so moved by the injustice of the result as to feel called upon to apologize for the decision.

In this case the District Court imposed the penalty with "regret" [R 492].

In *In re Central States Electric Corp.* (D. C. Va. 1953) 112 F. Supp. 281, appeal den. 206 F. 2d 70, cert. den. 346 U. S. 899, the Court applied §249 "with reluctance" (p. 288).

Where §249 does apply, and allowance must be denied, the Court does not regard even offending members of stockholder committees as utterly depraved. In *Finn* v. *Childs Co.* (2 C. A. 1950) 181 F. 2d 431, the Court said, per Clark, C. J. (p. 441):

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* *F. C. C.* v. *American Broadcasting Co., Inc.* (1954) 347 U. S. 284, 296.

[1] *Berner* v. *Equitable Office Bldg. Corporation* (2 C. A. 1949) 175 F. 2d 218, 222.

[2] *In re Norwalk Tire & Rubber Co.* (D. C., Ct. 1951) 96 F. Supp. 274, 276.

[3] *Third Avenue Transit Corporation* (S. D. N. Y. 1958) 159 F. Supp. 440, 443.

[4] *Surface Transit, Inc.* v. *Saxe, Bacon & O'Shea* (2 C. A. 1959) 266 F. 2d 862, 868, cert. den. 361 U. S. 862.

> "Since Frank and Hernon acted as 'representatives' of their group of friends, and thus of all the preferred stockholders, they must be denied compensation under the statute and their petition must be dismissed. *Of course this does not mean that their activity was improper.*" [Emphasis added.]

In the opinion of Judge Caffey in *In re Republic Gas Corporation* (S. D. N. Y. 1936) 35 F. Supp. 300, on which petitioners so largely rely, appears this passage (p. 306):

> "It is perhaps unnecessary to add, but out of abundance of caution I wish to add, that nothing I have said is intended in any way to reflect on the personal integrity of those who have been denied compensation."

In view of the harshness of the application of §249 in cases where it does apply, it would seem quite unnecessary to extend the statute to a salaried employee not within the statute's language or intent.

POINT IV.

Whether the District Court might have discharged respondent in an exercise of discretion is not before this Court for review, since that court did not purport to exercise a discretion. At all events, subsequent decisions exonerated respondent of all of the charges improperly made against him here.

In deciding on June 14, 1960, that §249 mandated Fried's discharge because he had traded in the stock of the Debtor, the District Court in effect severed that issue from a welter of charges of fraud and misconduct contained in a succession of petitions and amended petitions [R 245]. The

Court expressly held "that anything beyond violation of §249 of the Bankruptcy Act was moot" [R 257]. Hence, the District Court did not consider whether Fried's compensation should, or should not be terminated in the exercise of discretion. Accordingly, that question was not before the Court of Appeals* and is not before this Court.

The other charges made by the Wolf petitions were set down for hearing on September 26, 1960 [R 250-7]. When this hearing was held, the matter of Fried's discharge under the supposed requirement of §249 had been disposed of long previously. While these other charges are wholly irrelevant, it is only just to point out that, despite repeated efforts to capitalize on them in petitioners' brief, they have all been judicially determined adversely to petitioners in later decisions.

The matters dealt with by the District Court at the subsequent hearing are as follows:

Fried is the president and principal stockholder of Nazareth Enterprises, Inc., a corporation wholly independent of the Debtor. The Debtor's fairgrounds is under lease (or license) to Enterprises [R 556], which operates an automobile race track there. The lease, which predates the filing of the Chapter X petition [R 407], requires the

* It is well settled that an appellate court may only pass upon such questions as were determined below and that, where a case has been erroneously decided as a matter of law, it will not be affirmed because the Court below should have reached the same conclusion as a matter of discretion. *Purcell* v. *Summers* (4 C. A. 1942) 126 F. 2d 390, cert. den. 317 U. S. 640; *Bergin* v. *Kiron State Bank* (8 C. A. 1944) 145 F. 2d 189; *Fanning* v. *Williams* (9 C. A. 1949) 173 F. 2d 95; and *Maryland Casualty Co.* v. *United Corporation* (1 C. A. 1940) 111 F. 2d 443. In the case last cited the Court said, per Magruder, C. J., (p. 446):

> "Since the complaint was dismissed on the mistaken ground of lack of jurisdiction, the judgment appealed from should not be affirmed, even if there existed adequate grounds on which the complaint might have been dismissed as a matter of discretion."

lessee Enterprises to pay as rent 12% of the gross admissions, with the proviso that, on those days that the lessee operates the food concessions for the races, it must pay 15% of the gross admissions [R 560].

J & J Foods, Inc. is wholly owned by one LaGrotte and his wife, who are its only officers. It has an agreement with the Debtor giving it the exclusive privilege to sell foods on the Debtor's premises except on those days that automobile races are held [R 505]. In 1955, Enterprises made arrangements with J & J Foods, Inc., whereby the latter was granted the right to purvey food and drink at the races [R 415] in consideration for which it was to pay a percentage fee to Enterprises. The effect of this arrangement was to bring into operation the escalator clause of the lease increasing Enterprises' rental to 15%.

In 1956, Weinstein, as president of the Debtor, and Fried, for Enterprises, agreed orally to a modification of the lease whereby the rental would be reduced to 10% of the gross admissions, upon condition that Enterprises would increase the prize moneys paid to the contestants in the automobile races. The lower rate was to obtain for each racing day that the prize moneys exceeded $1500. It was anticipated that such increased prize moneys would attract better-known drivers as participants in the races, and this, in turn, would stimulate greater spectator interest and result in increased admissions, thus increasing the rentals to be paid to the Debtor. The modification was to take effect at the beginning of the 1957 racing season [S. M. 11913, 12199-200; record below 15937, 16222-3], and was to continue at the Debtor's pleasure [S. M. 11939-40; record below 15963-4]. Upon the assumption that the modification was a transaction in the normal course of the Debtor's business, no Court order approving it was sought or obtained. Thereafter, Enterprises continued to operate

under the modification. During the years 1957-1961, inclusive, Enterprises increased its purses by an aggregate of $59,362. Gross paid admissions rose from $49,300.74 in 1956 to $122,363.76 in 1961. Rentals paid the Debtor increased from $5,708.64 in 1956 to $12,663.07 in 1961 [App. A to Petitioners' Brief].

After extensive hearings, the District Court on June 28, 1961, rendered its decision [R 265], disposing of the several matters then before it as follows:

(a) It found no fraud in the execution of the lease;

(b) It found no diversion from the Debtor of any rental either by Fried or by Weinstein;

(c) It found no diversion of any moneys owing to the Debtor by virtue of the J & J Foods, Inc. transactions;

(d) It found that it would not be in the best interests of the Debtor to reject the lease;

(e) It absolved Weinstein of any liability whatsoever; and

(f) It found that the modification of the lease was invalid, solely because there was no previous order of the Court authorizing it. Accordingly, the Court directed Enterprises and, upon its failure, Fried as its "alter ego", to account to the Debtor for the difference between the rent actually paid and 15% of the gross admissions during the years in question (thus, in effect, rescinding the modification). "The basis of the assessment against Nazareth Enterprises, Inc. and upon its default Fried, of the difference between the rental paid and the rental due beginning with the 1957 season is predicated solely upon the failure to obtain the court's approval. * * *." [R 277].

On September 12, 1961, the Court entered an order upon its decision which, among other things, directed the account-

ing. Appeals from that order were taken to the Court of Appeals (a) by Enterprises and Fried to the extent that it rejected the modification of the lease, determined liability on their part and directed them to account; and (b) by petitioners to the extent that it found no fraud, absolved Weinstein from liability and found no liability by reason of the J & J Foods, Inc. transactions, and refused to cancel or reject the lease.

Thus, when the District Court had concluded its consideration of this second controversy, Fried and Weinstein had been exonerated, and an accounting of the rents had been ordered, solely because this modification, so highly advantageous to the Debtor, had not been submitted to the District Court in advance. This decision, carrying with it no implication of fraud, double dealing or misconduct on the part of Fried or Weinstein, is the shaky pedestal from which petitioners exhort this Court to high standards, inveigh against sin generally, blackguard respondents in such terms as "diversion of rents", "overreaching", "misconduct", "deliberate wrongdoing", "fraudulent or dishonest acts", "self-dealing" and "faithless fiduciaries", and publish in the appendix to their brief (p. 203A) as applicable to this case the penal statute against embezzlement.

But even this inadequate prop for abusive irrelevancies has fallen. The District Court's order for the accounting was reversed by the Court of Appeals[1] on May 4, 1962, a full six months before petitioners' brief was filed here. No petition for *certiorari* has been addressed to this decision of the Court of Appeals, and the time to do so has long since expired.

Except in the wild and disproven allegations of Wolf's many petitions before the District Court there is no foun-

[1] *Wolf* v. *Nazareth Enterprises, Inc., et al.*, 303 F. 2d 152.

dation whatever for the inexcusable charge of fraud and misconduct against Fried with which petitioners' brief is replete.[1]

Petitioners' flank approach upon a simple question of statutory construction suggests that petitioners are uncertain but that, after all, the Court of Appeals may have been right. That court properly ignored the unwarranted and sinister attack.

Conclusion.

The Court of Appeals correctly construed the statute and should be affirmed.

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[1] In fact the whole attack on Fried's and Weinstein's purchases is insincere. The shares purchased by them were so purchased to prevent a raid on the Debtor's stock by the very persons so piously now complaining of Fried's and Weinstein's conduct. One of Fried's purchases was actually triggered by information that Mr. Robbins, the present counsel for petitioners, had himself solicited the purchase of those shares [R 476]. Indeed, $50,000 had been placed in his account by a member of the Wolf group for the purpose of buying the Debtor's stock [R 296]. And, concededly, one member of the Wolf group, Philip, while the treasurer and a director of the Debtor-in-Possession during the period of the reorganization, along with the other members of the Wolf group acquired a beneficial interest in the Debtor's stock [Pet. Br. 8, 9; R 227, 575-6, 583].

CASE TWO

(No. 27,000)

Question Presented.

Where none of the Debtor's stock has been issued in the usual manner, but its property has been acquired with a portion of funds entrusted to the president for investment in the project which became the Debtor, and the president has distributed the Debtor's stock certificates, not only to such investors, but also to his creditors in payment of, or security for his unrelated personal obligations to them, are the latter in a reorganization court entitled to share with the former in the Debtor's stock?

Statement of the Case.

This is a controversy between persons who gave one John Malakoff moneys to invest in the Debtor's capital stock (hereafter "the investors") and personal creditors of Malakoff (hereafter "non-investors"), who did not intend to invest in the Debtor, but who received certificates of stock from Malakoff as security for, or in payment of, unrelated transactions. Malakoff in *Ponzi* fashion* had distributed "dividends" to the investors, no doubt from their own funds.

The District Court allotted the capital stock of the Debtor to both classes of claimants. The Court of Appeals reversed, allotting the stock of the Debtor to the investors only. The Debtor's charter had authorized 200 shares; Malakoff had distributed certificates for 316. Neither Court made its allotment in accordance with the certificates that had been issued. The District Court's allotment was upon a

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* *Cunningham* v. *Brown* (1924) 265 U. S. 1.

"net fair value of the investment in the Debtor" which, in the case of the non-investors, meant Malakoff's personal indebtedness to the stock claimant. The District Court charged each investor with the dividends that he had received. The Court of Appeals, allowing only the claims of the investors, did not reduce their participation by the amount of the dividends, but did direct that the shares to be issued to the investors should be subject to a lien, in the amount of such dividends, in favor of the corporation.

Respondent Fried is a member of the group designated above as investors and, accordingly, this brief is submitted in support of the decision of the Court of Appeals.

The detail of petitioners' statement of the case is for the most part acceptable to respondent. A few matters require emphasis, and others slight correction.

A "Philadelphia Group" caused the Debtor to be incorporated in Pennsylvania on August 1, 1951 [R 53]. Kipling Realty Co., a corporation controlled by the Philadelphia Group, on September 26, 1951, conveyed the Market property, subject to $18,000 in mortgages, to the Debtor (not to Malakoff) [R 54]. The price was $100 plus the assumption by the Debtor (not by Malakoff) of $57,135.92, representing the cash expenditures of the Philadelphia Group in the acquisition of the property, and for improvements. On October 17th Malakoff agreed with two members of the Philadelphia Group to pay $32,853.08 for the 20 shares of the Debtor's stock then outstanding, under an installment contract which provided that the stock was to be held by the sellers until payment was made [R 55].

It is a fair inference that the only payments made upon either of these obligations, i.e.: the assumption by the Debtor of the purchase price $57,135.92, and the obligation of Malakoff to pay for the 20 shares transferred to him, came from the funds of the investors.

Between March 14, 1951 and March 25, 1953, Malakoff collected from investors in the Nazareth project, which became the Debtor corporation, $160,362.34. Between June 26, 1951 and February 15, 1952, Malakoff paid to the Philadelphia Group $49,489 and, for the improvement of the Market property, $9,507, a total of $58,996 (Schedules A and B appended hereto)*. Malakoff also paid $11,032.84 to the Philadelphia Group. This payment, however, represents the insurance proceeds of windstorm damage sustained by the Debtor [R 57]. It was not his money.

Not all of these payments can be traced to the funds given Malakoff for investment. However, the fact as found [R 190], that Malakoff did not make a practice of investing his own funds, but obtained financing from others, the fact that he "always needed money" [R 296], the fact that he received the money of the investors for the express purpose of investment in the project, and the fact that Malakoff's payments to the Philadelphia Group always followed and never anticipated collections from the investors [Schedules A and B], enabled the Court of Appeals to find [R 589, 593] that the moneys expended for the acquisition of the Market by the Debtor were the moneys of the investors.

There was at the time of the filing of the reorganization petition a balance of $29,467.16 still due the Philadelphia Group either from the Debtor for the property, or Malakoff for the stock. That Group has not filed any proof of claim in this proceeding. Edward Malakoff stated in court that the Group did not intend to assert the indebtedness against the Debtor [R 57].

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* These schedules, compiled from original exhibits in the District Court, are also part of the record.

Malakoff was given possession of the Market from about the time of the inception of the corporation [R 52]. He did not, however, receive the 20 shares he had agreed to purchase, or the corporate books and records, until December 1952 [R 56]. Commencing February 2, 1953 [R 50], he distributed certificates of stock of the Debtor to investors whose funds he already held, to other investors who paid him for their stock later, and also to his personal creditors in payment of, or as security for his obligations to them in unrelated transactions.

At the denouement in June 1953, Malakoff turned his 20 shares back to the corporation together with a formal release of any and all claims against the Debtor [R. 57, 554-5].

There is nothing in the acquisition by the Debtor of the Market property, or by Malakoff of the original 20 shares, which would indicate that the capital stock of the Debtor ever actually belonged to Malakoff. Moreover, Malakoff, in his dealings with the investors, never himself claimed a beneficial interest in the capital stock of the Debtor. The earlier investments he purported to hold "in escrow" until the shares were available [R. 566, 568-9]. Most of the investors received from Malakoff a letter form of receipt which provided in part as follows [R. 186]:

> "You understand, of course, that all of the authorized stock of The Nazareth Farmers and Auction Market Inc. [sic] which owns the Market has been issued to me. Under our arrangements, I am obliged to you for a proportionate share of my earnings, dividends, liquidating or otherwise and profits from the Market as I receive them."

Here is a clear declaration of trust by Malakoff for the benefit of the investors. Thus, even if all of the authorized

stock be treated as having been issued to Malakoff, there was no claim on his part to a beneficial interest in it, but only to hold it as trustee for the investors. In no case did Malakoff have an interest which he could transfer to his creditors.

The claims of the 41 stock claimants were filed [R 45] pursuant to §196 of the Bankruptcy Act (11 U. S. C. 596). The Debtor objected to each claim. In addition, the so-called Margolis Group which included Ida May Margolis and William McK. Shongut, who have been recognized by the Court of Appeals as investors entitled to a stock interest [R 598], filed objections to all of the claims except those in that group. Thus, their objections were filed to the non-investors Kanter [R 58]; Danciger [R 146]; Manoochehrian [R 165]; Harry Forman [R 136]; Katzenell [R 177]; Seymour Forman [R 159].

Synopsis of Argument.

No conflict between federal and state law is presented. Neither New York nor Pennsylvania law imposes any obstacle to recognizing as shareholders of the Debtor those who bought and paid for their stock. Neither New York nor Pennsylvania law requires them to share the Debtor's capital stock with those to whom the promoter gave certificates as security for, or in payment of, his personal unrelated obligations.

Petitioners read into the opinion of the Court of Appeals a resolution of the controversy by "general or federal equity" when they say state law was available and should have been applied. The petitioners themselves walk a tight rope, leaning at one time toward New York and, at another, toward Pennsylvania.

Petitioners do not dispute the right of the investors to share in the Debtor's capital stock. They object, however, to this participation being based upon the financial contributions that the investors have made. Upon this point, they choose New York law. No trust can be raised, they say, in favor of the investors, because resulting trusts in real property have been abolished by § 94 of the New York Real Property Law. Petitioners claim that the non-investors cannot be excluded from participating in the Debtor's capital stock. For this contention they choose Pennsylvania law. None can be excluded, they say, because Pennsylvania lacks the remedy of equitable cancellation of illegally issued stock. In both instances they are wrong. The New York statute does not apply. Pennsylvania does not lack the equitable remedy of cancellation. Even if it did, this would be immaterial since § 196 of the Bankruptcy Act requires "proof * * * of the interests of stockholders", and the non-investors claims are not proven by a showing that the certificates were issued in violation of the Pennsylvania Constitution and statute.

The Debtor's capital stock came into existence with the acquisition by the Debtor of the Market. This acquisition, which is the only legitimate basis for the issuance of stock, was procured by the money with which the investors supplied Malakoff. Equity, both the New York and Pennsylvania brand, will impress, not on the Market, but on the Debtor's capital stock a trust for the benefit of the investors. To the objection that only those who contributed before the Market was acquired may benefit by such a trust, the answer is that all of the subscriptions were made through Malakoff; that even before he became president on October 17, 1951, he was permitted to act as the corporation's agent and, under well-established equitable prin-

ciples, the corporation is estopped as against these investors to assert that their money never actually came into the treasury.

The determination of the stock interests is not complicated, as petitioners would have it, by questions which might arise upon an over-issue. With the non-investors eliminated, there is no over-issue.

In apportioning the Debtor's capital stock between the investors in the amounts of their respective contributions, and subjecting their shares to a lien for dividends improperly paid, the Court of Appeals has properly fashioned an equitable remedy to meet the situation.

POINT I.

The capital stock of the Debtor belongs to the investors.

A. The right of the investors to share is not disputed.

None of the certificates of stock now presented by the stock claimants were issued in the regular manner. Checks were drawn to Malakoff personally and not to the corporation, and none of the money was paid directly into a bank account of the corporation. No one, however, disputes the right of the persons who paid their money to Malakoff as an investment in the project to share in the Debtor's capital stock. The Commonwealth of Pennsylvania has claimed no escheat. The legal representatives of Malakoff make no claim. Even petitioners would permit the investors to share in the capital stock, and only object to a basis of such sharing which would exclude the non-investors.

It seems only reasonable that those who put up their money for a share in the enterprise should be recognized as the owners of the Debtor's capital stock. If doctrinal support is necessary, it is found in the equitable principles both of a resulting trust and of estoppel.

B. A trust is properly impressed upon the Debtor's capital stock for the benefit of the investors, since it was their money which enabled the corporation to acquire the Market, the only consideration for the issuance of shares in that stock.

In disputing the availability of a resulting trust, petitioners choose New York law, which, they say, is applicable because of the "center of gravity" rule (Brief 75-7).

A trust in favor of the investors is fully authorized by New York law.

On September 26, 1951, the Debtor acquired the Market property from Kipling Realty Co., a corporation controlled by the Philadelphia Group [R 54]. For that acquisition, Malakoff paid the Philadelphia Group $58,996, which the Court of Appeals has found came from moneys paid him by the investors aggregating $160,362.35 (Schedules A and B annexed). The only consideration for which the stock of the Debtor could have lawfully been issued was the Market property, since that is the only asset that the corporation acquired.

"A constructive trust is the formula through which the conscience of equity finds expression."* While the present facts bear more of the characteristics of a resulting than of a constructive trust, unquestionably the New York courts would impose a trust for the benefit of the investors. This trust would be imposed, not upon the real property, as

* Cardozo, J., in *Beatty v. Guggenheim Exploration Co.* (1919) 225 N. Y. 380, 386.

petitioners seem to assume [Brief 74], but upon the Debtor's capital stock.*

Contrary to petitioners' contention [Brief 45, 110] New York Real Property Law §94 poses no barrier to the fixing of a trust on the Debtor's capital stock for the benefit of those who paid for it. There are two reasons:

(1) The statute does not apply to personal property. *Robbins* v. *Robbins* (1882) 89 N. Y. 251; *Coleman* v. *Mulligan* (N. Y. Sp. 1946) 66 N. Y. S. 2d 696.

(2) As put by Cardozo, Ch. J., in *Foreman* v. *Foreman* (1929) 251 N. Y. 237, 241:

> "Nothing in the statute as to the implication of resulting trusts is at war with this conclusion (Real Prop. Law, §94). The statute has put an end to the rule at common law that where a grant is made to one for a consideration paid by another a trust results inevitably and always, by force merely of the payment, irrespective of intention (*Garfield* v. *Hatmaker*, 15 N. Y. 475, 477; Scott, Resulting Trusts in Purchase of Land, 40 Harv. L. Rev. 675). The conveyance is operative according to its terms if nothing else is proved. The statute has no effect, however, on trusts constructively imposed as a consequence not of payment alone, but of payment in combination

* A distinction must be taken here between the capital stock of a corporation and the certificates representing its shares. "The moment a corporation has either franchises or property of any kind it has stock; • • •". *Burr* v. *Wilcox* (1860) 22 N. Y. 551, 556. The capital stock is "• • • the thing of real value, the money or property of the corporation put in to make up its capital, while a certificate of stock is but the evidence of an ownership of a part or share of the capital stock." *Parsons* v. *Ley* (Onondaga Sp. T. 1933) 158 N. Y. Misc. 32, aff'd. 243 A. D. 681, aff'd. 269 N. Y. 630. In the present case the Court of Appeals could not void the capital stock. All it did was to disregard certificates as conclusive evidence of stock ownership in determining stock claims. Here it might be said that the Market on arrival at the corporation was converted from real to personal property.

with other or extrinsic equities. As to this the decisions are uniform and ample. 'It is only the common-law trust for the benefit of an individual from whom the consideration for a grant issues, and resulting from the fact of payment of the consideration, and having no other foundation, that the statute abolishes' (*Carr* v. *Carr*, 52 N. Y. 251, 260; [other citations omitted]).

"Enough and ample there is here to put the case for the plaintiff in the field uncovered by the statute. His equity does not grow out of payment and nothing more. It is reinforced by words of promise, by the relation of man and wife, and by unequivocal acts of confirmation and performance. In such circumstances, the plastic remedies of the chancery are moulded to the needs of justice."

Here, even if the subject were real property, there is more than the mere fact of title in one and payment by another. The investors' equity "is reinforced by words of promise" and by the relation between the parties. The letter receipt reads in part [R 186]:

> "Under our arrangements, I am obliged to you for a proportionate share of my earnings, dividends, liquidating or otherwise, and profits from the Market as I receive them."

But the investors' equity is also reinforced "by unequivocal acts of confirmation and performance". Original issue of stock certificates were actually given them.

§94 of the New York Real Property Law has no counterpart in Pennsylvania. Petitioners concede that a resulting trust may be imposed in Pennsylvania [Brief 45],* but merely contend that it could not inure to the benefit of the investors who paid Malakoff for their stock interests

* See *Zahorsky* v. *Leschinsky* (1959) 394 Pa. 368, 127 A. 2d 362.

after February 15, 1952, when Malakoff ceased making payments to the Philadelphia Group for the Market.

C. The Debtor is estopped to deny membership in the corporation to those who invested with Malakoff, since he was acting within the scope of his authority as agent of the corporation.

Malakoff had been president of the Debtor since October 17, 1951 [R 56]. The By-Laws provided [Saul: Ex. I]:

> "[V]4. The President shall be the chief executive officer of the corporation; * * * he shall have general and active management of the business of the corporation, * * * and shall have the general powers and duties of supervision and management usually vested in the office of President of a corporation."

Before Malakoff was elected president, and from the very inception of the corporation on August 1, 1951, he had been its agent in charge of its affairs [R 52, 56]. Those who gave their money to Malakoff for investment were thus dealing with the chief executive officer of the corporation, or with its authorized agent, with whom investors and others having business with the corporation might properly deal. The investors each paid money in reliance upon the agent's representation that they were buying stock in the corporation. Under such circumstances the corporation is estopped to deny the authority of the agent to represent it. Such is the law in Pennsylvania which petitioners say governs the rights of stockholders *vis-a-vis* the corporation (Brief 72). *Appeal of Kisterbock* (1889) 127 Pa. 601, 18 A. 381. And in New York also, *NY & NH RR Co.* v. *Schuyler* (1855), 34 N. Y. 30. In *Krall* v. *Lebanon Valley Savings & Loan Association* (1923), 277 Pa. 440, 121 A.

405, the Court directed defendant corporation to recognize as valid shares of its stock issued to plaintiff for moneys paid to the corporation's treasurer, who had embezzled them. The Court said (p. 406):

> "Payment to the treasurer, on the facts in this case, may be considered payment to the association, regardless of what he did with the money; * * *."

The availability of an estoppel to all who made an investment through Malakoff after August 1, 1951, eliminates from the case the question whether those who invested with him after he ceased making payments for the acquisition of the Market on February 15, 1952*, may share with the earlier subscribers in the trust of the corporation's capital stock.

Petitioners claim [Brief 46, 105] that the investors cannot make proof of estoppel *vis-a-vis* the Debtor because they were put on notice that they were dealing not with the Debtor, but with Malakoff individually. For this they rely (1) on the fact that checks were made payable to Malakoff; and (2) upon the form of letter-receipt which the Examiner found [R 186] that most of the investors received. But the assertion "Malakoff openly professed to own all the stock himself" [Brief 105], is due to a failure to read the letter-receipt closely. That document says [R 186]:

> "You understand, of course, that all of the authorized stock of The Nazareth Farmers and Auction Market Inc. [sic] which owns the Market has been issued to me. Under our arrangements, I am obliged to you for a proportionate share of my earnings, dividends, liquidating or otherwise and profits from the Market as I receive them."

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* On this date a substantial part of the total moneys to be paid the Philadelphia Group remained unpaid.

Here is not the slightest suggestion that the investors are dealing with Malakoff as a seller. On the contrary, if all of the 200 authorized shares of stock of the Debtor had actually been issued to Malakoff, here is a declaration by Malakoff that those shares were being held by him in trust for the benefit of the investors. Of course, all of the authorized stock had not been issued to Malakoff. His representation is not that he is selling to the investors shares previously issued to him. The representation is in effect that, as agent of the corporation, Malakoff is issuing to himself, as agent for the investors*, the entire 200 shares of Nazareth.

The drawing of the checks to Malakoff rather than to the corporation is sufficiently explained by a further provision of the receipt [R 187]:

> "On the other hand, I may cause the dissolution of the Corporation and arrange for the formation of a limited partnership and your . . . shares will be applied as your contribution with a corresponding proportionate interest."

There is nothing, therefore, in either of these circumstances which should lead the investors to the belief that the money they had entrusted to Malakoff was not to be paid into the corporation or that he proposed to steal it.

D. The Debtor is not estopped to deny membership to those who dealt with Malakoff as an individual.

No such recognition need be given the creditors of Malakoff. They did not give him money for investment, but are counting on an antecedent indebtedness of Malakoff to

* There is, of course, no legal obstacle to Malakoff representing both the corporation and the individual investor, or one of them for part of the transaction and the other for the remainder. Restatement Agency, 2d Ed., §14 L., p. 76.

them as consideration for the issuance of the shares. The report of the Examiner gave recognition to those persons because of a provision in the Uniform Stock Transfer Act which validates a transfer for an antecedent indebtedness [R 202]. What is involved here, however, is not the consideration for a contract or for a transfer; it is the prejudice or detriment which will support estoppel.*

Judge Learned Hand in *Helvering* v. *Schine Chain Theatres, Inc.* (2 C.A. 1941) 121 F. 2d 948, 950, said:

> "But it is not necessary to reassert those rulings here, because there was no basis for an 'estoppel,' however broadly one uses that disastrous word. This is true because, however nebulous, it has always had at least this solid centre; that the party who invokes it shall have acted to his detriment in reliance upon what the other party has done. That was not the case here."

Appeal of Kisterbock, supra, is directly in point. There, the Supreme Court of Pennsylvania said (p. 383):

> "There is no finding that Elbert ever advanced any money on the shares delivered to Kisterbock either to Morton or to any one else. There is not even a finding that they were delivered to Elbert as security for an antecedent indebtedness due by Morton to him or even that there was such indebtedness. But if there had been such a finding, or if such had been the fact, Elbert would not have been entitled to any relief on that account as against the company, because, in that event, Elbert parted with nothing on the faith of the certificates, and he would fail to bring

* Under provisions of the New York Stock Corporation Law similar to those of Pennsylvania, stock may not be issued for an antecedent indebtedness of the corporation itself. *In re Paul Delaney Co., Inc.* (W. D. N. Y. 1927) 23 F. 2d 737; *In re Progressive Wall Paper Corp.* (2 C. A. 1916) 229 F. 489. *A fortiori* the stock could not be issued for a past indebtednes of an officer.

himself within the principle upon which alone indemnity could be given, * * *."

To invoke an estoppel, therefore, the stock claimant must have taken a step to his detriment in reliance on the representations of Malakoff. In the case of the investors, this is manifest. They parted with their money. In the case of the others, they were as well or as badly off after receiving the stock certificates as they were before.

Furthermore, the Debtor is compelled to accept claimants as stockholders only if they dealt with Malakoff as agent of the corporation. When he solicited and received moneys for investment in the corporation he was acting as the corporation's agent and the corporation became responsible for his acts. *New York and New Haven R. R. Co.* v. *Schuyler* (1865) 34 N. Y. 30, at p. 50. On the other hand, where the claimant received what purported to be the original issue of stock of the corporation in a transaction or series of transactions with Malakoff personally, the Debtor incurred no liability to the claimants. In *Manhattan Life Insurance Company* v. *The Forty-Second Street Company* (1893) 139 N. Y. 146, the Court, per Maynard, J., said (p. 151):

> "But, without determining what are the duties of the officers of a corporation, when called upon to respond to the inquiries of intending purchasers of the stock, there is a sufficient reason why the plaintiff cannot avail himself of the representations of Allen in regard to the genuineness of this certificate. They were made in a private and personal transaction, undertaken for his individual benefit, and so understood by the plaintiff. The plaintiff knew that Allen, in the negotiation of the loan, was not acting as the officer or agent of the defendant, or in its behalf, and that his personal interest in the transaction

might lead him to betray his principal. It is an old doctrine, from which there has never been any departure, that an agent cannot bind his principal, even in matters touching his agency, where he is known to be acting for himself, or to have an adverse interest."

POINT II

Non-investors who received stock certificates in payment of, or as security for Malakoff's personal and unrelated obligations, may not be recognized as having a stock interest in the Debtor.

A. The certificates which petitioners hold were illegally issued and, therefore, cannot participate in the bankruptcy reorganization, irrespective of the Debtor's remedy under Pennsylvania law.

The jurisdiction of the Bankruptcy Court has continuously attached since 1953 and the Debtor is still plodding its way toward a reorganization. The fact that successful management by Weinstein and Fried has now given a substantial value to the stock does not take the Debtor out of the operation of the Bankruptcy Act. In order to share in the reorganized corporation which is to emerge it is necessary for petitioners to establish their interests as stockholders in the coming reorganization.

The Bankruptcy Act provides:

> "Sec. 196. After the approval of the petition the judge shall prescribe the manner in which and fix a time within which the proofs of claim of creditors and of the interests of stockholders may be filed and allowed. Objections by any party in interest to the allowance of any such claims or interests shall be heard and summarily determined by the court."

Thus, the claims of petitioners to interests as stockholders had to be, and were filed and, since they were challenged [R 45], had to be proved. According to *In re American Fuel & Power Co.* (6 C. A. 1941) 122 F. 2d 223, appeal dismissed 322 U. S. 379 (p. 229):

> "The claim of a creditor or the interest of a stockholder which is invalid because it is based on or arises out of an illegal or criminal transaction, is not provable or allowable in bankruptcy reorganizations."

As governing the relationship of the non-investors to the Debtor, petitioners (Brief 73) choose Pennsylvania law. But the substantive law of Pennsylvania in Constitution and statute clearly excludes the non-investors from participation in the capital stock of the Debtor.

The issuance of certificates of stock to petitioners was an illegal transaction. The Debtor is a Pennsylvania corporation. The Constitution of Pennsylvania, Article XVI, §7, provides:

> "No corporation shall issue stocks or bonds except for money, labor done, or money or property actually received; and all fictitious increase of stock or indebtedness shall be void".

The Constitution, it is true, is not self-executing. But at all times material here, the Constitution has been implemented by the Act of May 5, 1933, P. L. 364, 15 Purdon's Stats. Ann. §2852-603, which both before and after the amendment of July 11, 1957 (P. L. 711, §1) provided in part as follows:

> "Shares of a business corporation shall not be issued except for money, labor done, or money or property actually received."

After citing the forerunner of this section, this Court, in *McCandless* v. *Furlaud* (1935) 296 U. S. 140, said, per Cardozo, J: (p. 161):

> "There are decisions in Pennsylvania that the Constitution is not self-executing. *Grange National Bank* v. *Collman*, 306 Pa. 200; 159 Atl. 26. That holding is irrelevant as to corporations such as this one, for there exists as to them an 'implementing' statute (Purdon's Penna. Stats., *supra**), without restriction as to the form of remedy."

The same Act in § 2852-610 provides:

> "The fact that shares are issued in violation of, or without full compliance with, the provisions of this act shall not make the shares so issued invalid, unless they are issued in violation of Article XVI, Section seven, of the Constitution of this Commonwealth."

Thus, the issuance of the stock certificates held by petitioners was illegal both by Constitution and by implementing statute.

By a clever juxtaposition of the parties, petitioners claim that, on the faith of the pieces of paper that they hold, they may intrude into the reorganization of the Debtor to which they have neither contributed nor intended to contribute money, labor or property. Under Pennsylvania law, they say, stock illegally issued may not be canceled. The only remedy left to a corporation which has thus been intruded upon is by call and assessment, and by foreclosure

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* This Court refers to Act of April 17, 1876, P. L. 30, 32, §4, Purdon's Pa. Stats. Title 15, §131, which read "* * * no such corporation shall issue either bonds or stock except for money, labor done or money or property actually received and all fictitious increase of stock or indebtedness in any form shall be void; * * *". This section was superseded by §2852-603 quoted above at the time of the enactment of the Business Corporation Law of May 5, 1933.

on the stock for the benefit of the corporation. Happily for them, they say, the District Court has already dismissed counterclaims of the Debtor for the subscription price. With this determination as *res judicata* [Brief 42-44]*, they can laugh at the futility of the judicial process, and retain a stock interest in the corporation as a windfall.

The difficulty with this clever solution is not only that it is based upon a false premise [B, *infra*], but that it has transposed the position of the parties. It is quite irrelevant whether a Pennsylvania court could grant the equitable remedy of cancellation at the suit of the corporation or of a complaining stockholder. The Debtor here is not looking for a remedy, and needs none. Despite the repeated statements in the brief, the Court of Appeals has not decreed cancellation of any shares.

What has happened is that petitioners have failed to establish such stockholding in the Debtor as will entitle them to participate in the coming reorganization. For this purpose, the Debtor-in-Possession (as trustee) is cast in the role, not of plaintiff but of defendant.** In that capacity it may defend on the ground that the stock has been issued contrary to Constitution and statute. Petitioners cannot establish their interest upon the fact that they received the stock certificates in payment of, or as security for an obligation owed by the promoter in a transaction in which the corporation got nothing.

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* There is no *res judicata*. The District Court, having granted petitioners' stock claims, had no recourse but to dismiss the counterclaims for the subscription price. These could only have been allowed if the Court had found there was no consideration for the issuance of petitioners' shares. Should this Court hold that the shares were issued without consideration but petitioners are entitled to retain them, the issue whether they must now pay for them would be revived.

** Petitioners go at least half-way on this. They say [Brief 71]: "Here, the 36 stock-claimants are all plaintiffs (so to speak) competing for allowances in a limited pool of corporate stock; the Debtor is a nominal party."

True, under Pennsylvania law, the stockholder's *prima facie* case is his stock certificate in regular form [Brief 98], but in no instance does the case rest there. In each claim now in dispute, it was proved to the satisfaction of the Court of Appeals [R 591, 595-9], that petitioners had neither made nor intended to make any investment in the Debtor, and that the certificates that they received were in each case given them by the promoter in satisfaction of, or as security for his personal indebtedness to them in transactions wholly unrelated to the Debtor and its affairs.

B. It is not true that Pennsylvania lacks the remedy of equitable cancellation of stock unlawfully issued.

The cancellation of certificates of capital stock unlawfully issued is part of the equity jurisdiction which Pennsylvania has inherited in common with her sister states. Commencing with the Supreme Court of Alabama, *Crow* v. *Florence Ice & Coal Co.* (1905) 143 Ala. 541, 39 So. 401, the Court said (39 So. 402):

> "Equity jurisdiction to declare the issuance of fictitious stock in a corporation void, and to have the certificates representing such stock cancelled, cannot be questioned."

Recognition of the right of cancellation is overwhelming. *Diamond State Brewery, Inc.* v. *De La Rigaudiere* (1941) 25 Del. Ch. 257, 17 A. 2d 313; *Ellis* v. *Penn Beef Co.* (1911) 9 Del. Ch. 213, 80 A. 666; *McGhee* v. *Minor* (1939) 188 Ga. 635, 4 S. E. 2d 565; *Therm-O-Proof Insulation Mfg. Co.* v. *Hoffman* (1946) 329 Ill. App. 645, 69 N. E. 2d 725; *Gentilly Land Co.* v. *Crawford* (1954) 225 La. 837, 74 So. 2d 47; *Meier* v. *First Citizens Bankers Corp.* (1938) 301 Mass. 410, 17 N. E. 2d 106; *Koppitz-Melchers, Inc.* v. *Koppitz* (1946) 315 Mich. 582, 24 N. W. 2d 220; *B. & C. Electrical Construction*

Co. v. *Owen* (4th Dept. 1917) 176 App. Div. 399, aff'd. 227 N. Y. 569; *Evans* v. *Ideal Brick & Brickcrete Mfg. Co.* (Sup. Ct. Okla. 1955) 287 P. 2d 454; *McAlister* v. *Eclipse Oil Co.* (Tex. Civ. App. 1936) 92 S. W. 2d 545, reversed on other grounds 128 Tex. 449, 98 S. W. 2d 171 and *Floor* v. *Johnson* (1948) 114 Utah 313, 199 P. 2d 547.

It is therefore, not surprising to find that, despite petitioners' assertions to the contrary, Pennsylvania does not lack the equitable remedy of cancellation of stock certificates. In *Fraser Fund* v. *Fraser* (1944) 350 Pa. 553, 40 A. 2d 22, the court granted cancellation of stock issued in violation of a contract between stockholders. *A fortiori*, Pennsylvania would recognize the remedy of equitable cancellation of certificates issued in violation of Constitution and statute.* A cancellation of stock issued without consideration was granted in *Shipley* v. *Monticue Lines* (Com. Pleas Fayette Co., 1941) 4 Fayette Legal Journal 293. The remedy has also been granted in Federal Courts sitting in Pennsylvania: *Bingaman* v. *Commonwealth Trust Co.* (M. D. Pa. 1926) 15 F. 2d 119; *In re Chemical Lime Co.* (M. D. Pa. 1938) 25 F. Supp. 347.

In *Petrishen* v. *Westmoreland Finance Corporation* (1959) 394 Pa. 552, 147 A. 2d 392, the court below had granted cancellation of stock certificates upon the ground that they had been issued illegally. The Supreme Court reversed, not upon the ground that the court was without power to cancel the certificates, but because the contract of subscription, pursuant to which the stock had been issued,

* The Debtor-in-Possession is in position to take advantage of any right of cancellation Pennsylvania may afford. In each instance where the Court of Appeals disallowed a claim, not only the Debtor, but also the Margolis Group had filed objections to such claims. This group includes Shongut and Ida Margolis (R 45) whose claims were both allowed, at least in part, by the Court of Appeals (R 598). The group filed objections to Kanter (R 58); Danciger (R 146); Mahoochehrian (R 165); Harry Forman (R 136); Katzenell (R 177); Seymour Forman (R 159).

did not violate the Constitution or statute. In the rather full opinion there is not even a suggestion that the court was without power to cancel the stock if it should find that its issuance was illegal. Indeed, that question seems to have been determined by this Court in *McCandless* v. *Furlaud* (1935) 296 U. S. 140, 161, where it was said that Pennsylvania had an "implementing" statute "without restriction as to the form of remedy."

Petitioners rely upon *Fetter* v. *Delaware Valley R. R. Co.* (1903) 206 Pa. 485, 56 A. 57 and *Bradford County Telephone Co.* v. *Young* (1938) 329 Pa. 433, 198 A. 96, in both of which cases stockholders were denied the remedy of a cancellation of securities unlawfully issued. But in each case, the former under the Railroad Act and the latter under a Public Utility statute, the law had provided for such a suit by the Attorney General and it was held that that remedy was exclusive. In the case of a private corporation where no such remedy is given to the Attorney General, such a suit for cancellation is manifestly within the powers of a Pennsylvania court.

In *Bradford*, the Court was emphatic that the illegal issue of the securities could be asserted by the corporation as a defense, saying, per Stern, J. (p. 99):

> "Of course, this principle does not prevent such a corporation, or any other, under proper circumstances, in an action brought against it to recover payment of its bonds or mortgage, from defending on the ground that the securities were issued in violation of law." (Citing cases)

Hence there can be no question but that the Debtor may resist the attempt to establish reorganization interests upon illegal transactions, and may do so with the full concurrence of the Pennsylvania authorities.

C. The remedy of call and assessment on stock certificates was not intended as a substitute for cancellation of stock unlawfully issued.

To the suggestion that the machinery for realization of the subscription price is in Pennsylvania a substitute for cancellation of the stock certificates there are two ready answers:

(1) Petitioners never entered into any contract of subscription* for the shares they now seek to prove. In no case was a certificate received under an agreement to pay for it. In every case, except where it was accepted as security, the certificate was received as payment, and that ended the transaction. To any call or assessment petitioners could have replied that they had never subscribed.

Petitioners' cases are inapplicable.

In *Petrishen* v. *Westmoreland Finance Corporation* (1959) 394 Pa. 552, 147 A. 2d 392, the Court below had granted cancellation at the suit of a stockholder. The Supreme Court reversed, not because the action did not lie, but because the Court regarded the arrangement that the corporation made with its manager to procure his experienced services, whereby the stock was to be issued to him when the corporation's earnings amounted to $30,000, not violative of the constitutional provision. Similarly, in the Third Circuit case of *Grafton* v. *Masteller* (1956) 232 F. 2d 773, the Court held valid an agreement with the plaintiff whereby corporate shares were allotted to him, the certificate to be delivered to him when earnings upon the shares equaled the par value. By this agreement also, the services of plaintiff, an engineer, were procured for the corporation.

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* "Subscription" is a prerequisite to call and assessment. 15 Purdon Pa. Stat. §2852-604, 605.

Certainly, neither of these cases is authority for the proposition that corporate shares may be issued and delivered to satisfy the president's personal debts. Both in *Bell* v. *Aubel* (1943) 151 Pa. Super. 569, 30 A. 2d 617 and in *Grange National Bank* v. *Collman* (1932) 306 Pa. 201, 159 A. 26, it was held that the constitutional prohibition could not be interposed as a defense to a suit on a stock subscription. Manifestly, as these Courts pointed out, the constitutional provision was not intended as a shield whereby a subscriber might avoid his obligations. In these cases, of course, there were actual subscriptions. There could be little doubt that, if a situation were presented to a Pennsylvania court in which a certificate had been issued without any agreement to pay for it, the mere issue of the certificate, being to all intents and purposes a blank piece of paper,* could not support an action for assessment. Accordingly, it is entirely consistent with respondents' position in this case that the counterclaims against petitioners for the assessments, based upon contracts of subscriptions that they never made, should have been dismissed.

(2) Where stock is void at its issuance there can be no assessment.

The Constitutions of Arizona and of Oklahoma contain provisions similar to those of Pennsylvania with reference to the issuance of stock. In *Hirschfeld* v. *McKinley* (9 C. A. 1935) 78 F. 2d 124, cert. den. 297 U. S. 703, a bankruptcy trustee of an Arizona corporation sought to recover from a purported stockholder upon a call and assessment based

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* *Hirschfeld* v. *McKinley* (9 C. A. 1935) 78 F. 2d 124, cert. den. 297 U. S. 703; *B. & C. Electrical Construction Co.* v. *Owen* (4th Dept. 1917) 176 App. Div. 399, aff'd. 227 N. Y. 569. In the latter case the Court, in affirming a judgment cancelling a certificate for shares of stock which had been issued without valid consideration, said of that certificate (p. 400): "It was, in effect, like so much blank paper".

upon shares issued without consideration. The Court, in denying recovery, said (p. 134):

> "It would seem an anomaly for a court to order an assessment on corporate stock unless it believed that such stock was, for some purposes at least, valid."

And again (p. 135):

> "Accordingly, we hold that no action ex contractu can be maintained against the purported stockholders of the Hollander Drug Company, in the form of an assessment and call based upon the attempted issue of shares to them, for the reason that, at least as far as Dr. Craig was concerned, such issue was in direct contravention to the Constitution of Arizona and therefore was 'a blank piece of paper,' 'for all purposes,' 'as against any person' ".

Likewise, in *Stone* v. *Hudgens* (W. D. Okla. 1955) 129 F. Supp. 273, the Court, upon the ground that the stock had been issued in violation of the Oklahoma Constitution, denied a recovery to a trustee in bankruptcy seeking to enforce an assessment upon the stock.

In the neighboring state of Delaware, which is not unfamiliar with corporations and corporate procedure, it was said in *Bush* v. *Hillman Land Co.* (Ct. of Ch. 1938) 2 A. 2d 133, at p. 135:

> "It may well be true, as the demurrants contend, that if the stock was issued without consideration, it was not void but only avoidable, and that it was accordingly permissible for the corporation to pursue the remedies provided in the General Corporation Law to enforce payment thereon for the benefit of creditors [citing cases]; or it may be conceded arguendo without deciding, that assumpsit or trover would lie for the value of the stock. Even so, such remedies as those are in affirmance of the stock as

outstanding stock. The corporation has the right to insist, however, that the stock shall be stripped of its character of issued and outstanding stock."

POINT III.

The Court of Appeals in fixing the stock interests of the investors in accordance with the amounts invested acted well within the applicable powers of equity.

A. The decision below has eliminated any question of overissue.

The question what a corporation must do where there has been an overissue of its capital stock with respect to the overissued shares is not posed here. The certificates handed out represent a total of 316 shares. 200 shares were authorized. With the 166 eliminated which were illegally issued, there is no overissue.

B. The method of allocating stock interests between the investors works no injustice.

The Court of Appeals did not cancel the Debtor's shares. It merely failed to accept stock certificates as conclusive evidence of the respective stock interests. The Court of Appeals said [R 593]:

> "Greater equity will be achieved by calculating the allowed claims in terms of dollars rather than in invalidly issued shares."

Equity required this because in an original issue of shares the price should have been fixed by the board of directors and should have been the same for all. While most paid $1,000, some paid only $600, and some less

[R 593]. Furthermore, provision had to be made for the so-called "dividends" of 20% that had been paid by Malakoff and accepted on the basis of the amount invested [R 199]. In fixing the proportionate interest according to the investment, and providing for a lien in favor of the corporation for the so-called "dividends", the Court was molding its decree to the facts, as it should have done. "The essence of equity jurisdiction has been the power of the Chancellor to do equity and to mold each decree to the necessities of the particular case".*

In *Getty* v. *Devlin* (1873) 54 N. Y. 403, shares of stock had been issued both to persons who had paid valuable consideration and to others who had paid nothing. The Court (p. 416) suggested as part of the relief "a redistribution of the stock among the *bona fide* subscribers alone", but left that as a matter of detail to the court below. Such a "redistribution" is the net result achieved by the court below in this case.

Petitioners argue that this method of allocation results in an unjust enrichment of the investors [Brief 48, 111]. Taking these dollar values, as the Court has found, as percentages of the Debtor's entire capital stock, petitioners say, for example, that Weinstein's stock interest is advanced from 3.5% (7 shares out of 200 authorized) to 4.79% [Brief 111]. But each of the investors might reasonably expect that, when all the shares had been sold, the total assets of the corporation at its inception would be $200,000. As against this, the corporation acquired real property at cost of $58,996 [Examiner's J, Saul] and, even if the forgiveness by the Philadelphia Group is added, of only $89,989 in all. No working capital went into the

* *Hecht Co.* v. *Bowles* (1944) 321 U. S. 321, 329. See also *Brown* v. *Board of Education* (1955) 349 U. S. 294, 300.

treasury. The small increase in the proportion of ownership, therefore, cannot be said to be a windfall.

C. No different provision need be made for the so-called Margolis Group.

The same principles which award stock interests to the investors and deny them to Malakoff's personal creditors apply to the claims of the Margolis Group. The Court of Appeals gave the same consideration to each of the Margolis claimants as it did to the others. Some it found to be investors, and allowed the claims; some it found to have received their shares in payment of Malakoff's personal debts, and disallowed their claims [R 597-8]. This group has not petitioned for *certiorari*.

Petitioners' bare statement [Brief 61] that they include the Margolis Group as respondents clearly affords no basis for delaying this reorganization further by sending these claims back to receive the same determination that they already have. At all events, not having petitioned for *certiorari*, the Margolis Group, both favored and unfavored, are deemed to have acquiesced in the decision of the Court of Appeals and, as to them, that decision is final.

Conclusion.

The Court of Appeals was not required to make a choice of law. Petitioners have failed to point out any rule of substantive law in either New York or Pennsylvania which runs contrary to the decision reached below. Under the law of both states, the investors are entitled to their investments in the Debtor by a clear resulting trust, if not, indeed, by an express trust. In any event, the Debtor, as against the investors, is estopped to deny validity to their stockholdings. The suggestion, if at all material, that Pennsylvania

lacks the remedy of an equitable cancellation of stock certificates, is simply incorrect. Pennsylvania has that remedy, and if the bankruptcy procedure had not intervened the corporation or the investing stockholders would have had it against the certificates held by Makakoff's creditors, for which it was never intended that the corporation receive any consideration.

The method of allotting the respective interests of the investors as between themselves, employed by the Court of Appeals, is well within the flexible powers of equity.

The decision of the Court of Appeals should be affirmed.

Dated: New York, N. Y.,
January 15, 1963.

Respectfully submitted,

HAROLD HARPER,
VINCENT P. UHLEIN,
Counsel for Respondent Jerome Fried.

SCHEDULE A

Payments by Nazareth Investors to John Malakoff from March 14, 1951 to March 25, 1953.

1951	Name	Claimants' Exhibit No.	Amount
Mar. 14	Samet	2	$ 1,500
Apr. 2	G. Klein	5	2,000
Apr. 10	Samet	2	500
Apr. 10	Kanter	5	2,667
Apr. 10	Kanter*		1,333
Apr. 10	Mintz	(Dr's. K m	4,000
Apr. 10	D. Graveson	(Saul	4,000
June 1	D. Clark	2	500
Aug. 1	B. Clark	2 & 3	3,000
Aug. 1	Masur	3	3,000
Aug. 1	B. Clark*		1,000
Aug. 14	F. Como*		4,000
Aug. 14	L. Como*		4,000
Aug. 25	Hull	3	2,400
Aug. 30	Bikales*		5,000
Sept. 1	J. Fried		2,000
Sept. 11	Treat	4	2,000
Sept. 12	Masur	4	400
Sept. 17	M. Klein	2	1,200
Sept. 18	Kane	5	2,000
Sept. 19	Weinstein	4	7,000
Sept. 19	Spielholtz	2	1,200
Sept. 20	Saul	4	3,000
Sept. 20	G. Klein	6	1,200
Sept. 29	D. Clark	2	1,125
Oct. 4	Hull	3	1,200
Oct. 18	Laupheimer	5	4,500
Oct. 18	Laupheimer*		500
Oct. 31	Bluestone	4	2,000
Nov. 2	Kane	6	1,000
Dec. 7	A. Fried	2	1,000
Dec. 20	Rosen	3	3,500
1952			
Jan. 4	Rosen	6	1,500
Jan. 7	A. Fried	3	1,000
Jan.	G. Klein*		500
Jan. 21**	G. Klein	7	2,300

* Payments made by cash.

** Total payments including this date $79,025.

1952	Name	Claimants' Exhibit No.	Amount
Mar. 5	Rosen	9	$ 1,000
Mar. 11	D. Clark	2	200
Mar. 27	D. Clark	2	500
Apr. 10	G. Klein	8	2,000
July 25	H. Schwartz	3	2,000
July 30	D. Clark	2	550
Oct. 20	A. Fried	3	1,000
Nov. 10	Masur	5	500
Nov. 15	G. Klein	4, 2	6,000
Dec. 12	Lapp heimer	4, 2	3,000
Dec. 14 & 15	Pollack	4	7,000
Dec. 16	Pollack	Cash	1,500
1953			
Jan. 14	G. Schwartz	4	2,000
Jan. 14	H. Schwartz	4	2,000
Jan. 25	Spielholtz	3	1,800
Feb. 2	F. Como	Cash	2,000
Feb. 2	L. Como	Cash	2,000
Feb. 17	Kaplan	2	1,000
Feb. 27	Bond	3	1,000
Mar. 1	P. Como	Cash	8,000
Mar. 16	Noire	3	5,000
Mar. 17	T. Schwartz	4	3,000
Mar. 20	H. Forman	7	6,000
Mar. 20	H. Forman	3	5,000
Mar. 25	Grossman	2	2,000
			$145,075

The above amount does not include the sum of $6,287.34 paid by William McK. Shongut during 1953, nor the sum of $9,000 paid by Ida May Margolis during 1951, as found by the Court of Appeals [R 598].

Schedule B.

Payments by John Malakoff to Edward Malakoff, et al. for Purchase of the Market Property [Examiner's J, Saul]

1951			
June	26	$ 3,750.00	
July	7	10,000.00	
Aug.	16	2,250.00	
Aug.	18	739.00	
Aug.	18	750.00	
Sept.	11	5,000.00	
Sept.	13	5,000.00	
Sept.	21	5,000.00	
Oct.	16	2,500.00	
Oct.	24	2,500.00	
Oct.	25	2,500.00	
Oct.	29	2,500.00	
Dec.	20	2,853.08	
1952			
Jan.	3	2,146.92	
Feb.	15	2,000.00	
			$ 49,489.00
Add: Payment in November, 1951, to Casper Simmers for Nazareth Improvements (Ex's BW, Saul Claim)			9,507.00
Total Payments by John Malakoff			$ 58,996.00

Recapitulation

Total Payments by Nazareth Investors to John Malakoff	$160,362.34
Total Payments by John Malakoff for Purchase of Market Property	$ 58,996.00
Excess received by John Malakoff	$101,366.34

APPENDIX.

Bankruptcy Act.

SEC. 188 [11 U. S. C. §588]. A debtor continued in possession of its property shall have all the title, be vested with all the rights, be subject to all the duties, and exercise all the powers of a trustee appointed under this chapter, subject, however, at all times to the control of the judge and to such limitations, restrictions, terms, and conditions as the judge may from time to time prescribe.

SEC. 191 [11 U. S. C. §594]. A trustee or debtor in possession may employ officers of the debtor at rates of compensation to be approved by the court. No person shall become an officer or director of the debtor, to fill a vacancy or otherwise, without the prior approval of the court.

SEC. 196 [11 U. S. C. §596]. After the approval of the petition the judge shall prescribe the manner in which and fix a time within which the proofs of claim of creditors and of the interests of stockholders may be filed and allowed. Objections by any party in interest to the allowance of any such claims or interests shall be heard and summarily determined by the court.

ARTICLE XIII—COMPENSATION AND ALLOWANCES.
[11 U. S. C. §§641-650.]

SEC. 241. The judge may allow reimbursement for proper costs and expenses incurred by the petitioning creditors and reasonable compensation for services rendered and reimbursement for proper costs and expenses incurred in a proceeding under this chapter—

(1) by a referee;

(2) by a special master;

(3) by the trustee and other officers, and the attorneys for any of them;

(4) by the attorney for the debtor; and

(5) by the attorney for the petitioning creditors.

Such compensation of referees and trustees shall not be governed by sections 40 and 48 of this Act.

SEC. 242. The judge may allow reasonable compensation for services rendered and reimbursement for proper costs and expenses incurred in connection with the administration of an estate in a proceeding under this chapter or in connection with a plan approved by the judge, whether or not accepted by creditors and stockholders or finally confirmed by the judge—

(1) by indenture trustees, depositaries, reorganization managers, and committees or representatives of creditors or stockholders;

(2) by any other parties in interest except the Securities and Exchange Commission; and

(3) by the attorneys or agents for any of the foregoing except the Securities and Exchange Commission.

SEC. 243. The judge may allow reasonable compensation for services rendered and reimbursement for proper costs and expenses incurred by creditors and stockholders, and the attorneys for any of them, in connection with the submission by them of suggestions for a plan or of proposals in the form of plans, or in connection with objections by them to the confirmation of a plan, or in connection with the administration of the estate. In fixing any such allowances, the judge shall give consideration only to the services which contributed to the plan confirmed or to the refusal of confirmation of a plan, or which were beneficial in the administration of the estate, and to the proper costs and expenses incidental thereto.

SEC. 244. Where a petition is filed under section 127 of this Act, the judge may allow, if not already allowed, reasonable compensation for services rendered and reimbursement for proper costs and expenses incurred in the pending bankruptcy proceeding—

(1) by a marshal, receiver, or trustee, as provided in subdivision g of section 48 of this Act, and the attorneys for any of them;

(2) by the attorney for the petitioning creditors;

(3) by the attorney for the bankrupt; and

(4) by any other persons and the attorneys for any of them entitled under this Act to compensation or reimbursement in such bankruptcy proceeding.

SEC. 245. Where a petition is filed in a pending bankruptcy proceeding, the judge may allow reasonable compensation for services rendered and the proper costs and expenses incurred in such bankruptcy proceeding by a referee in bankruptcy. In fixing such compensation, the judge shall not be restricted by the provisions of section 40 of this Act.

SEC. 246. Upon the dismissal of a proceeding under this chapter, or the entry of an order adjudging the debtor a bankrupt, the judge may allow reasonable compensation for services rendered and reimbursement for proper costs and expenses incurred in such proceeding prior to such dismissal or order of adjudication by any persons entitled thereto, as provided in this chapter, and shall make provision for the payment thereof, and for the payment of all proper costs and expenses incurred by officers in such proceedings.

SEC. 247. The judge shall fix a time of hearing for the consideration of applications for allowances, of which hearing notice shall be given to the applicants, the trustee, the debtor, the creditors, stockholders, indenture trustees, the Securities and Exchange Commission, and such other persons as the judge may designate, except that, in the case of allowances for services and reimbursement in a superseded bankruptcy proceeding, notice need be given only to the applicants, the debtor, the trustee, and the unsecured creditors, and may be given to such other classes of creditors or other persons as the judge may designate. In the

case of the dismissal of a proceeding under this chapter and the entry of an order therein directing that bankruptcy be proceeded with, notice of the hearing to consider allowances need not be given to stockholders.

SEC. 248. In the case of the dismissal of a proceeding under this chapter and the entry of an order therein directing that a superseded bankruptcy be proceeded with, the compensation allowed by the judge, in the course of the proceeding under this chapter, to the referee, marshal, receiver, or trustee in the bankruptcy proceeding for services rendered by them in such bankruptcy proceeding shall be deemed to have been allowed in such bankruptcy proceeding, and such compensation shall be considered in connection with the making of future allowances therein or shall be readjusted, so as to comply with the provisions of this Act fixing their compensation in a bankruptcy proceeding.

SEC. 249. Any persons seeking compensation for services rendered or reimbursement for costs and expenses incurred in a proceeding under this chapter shall file with the court a statement under oath showing the claims against, or stock of, the debtor, if any, in which a beneficial interest, direct or indirect, has been acquired or transferred by him or for his account, after the commencement of such proceeding. No compensation or reimbursement shall be allowed to any committee or attorney, or other person acting in the proceedings in a representative or fiduciary capacity, who at any time after assuming to act in such capacity has purchased or sold such claims or stock, or by whom or for whose account such claims or stock have, without the prior consent or subsequent approval of the judge, been otherwise acquired or transferred.

SEC. 250. Appeals may be taken in matters of law or fact from orders making or refusing to make allowances of compensation or reimbursement, and may, in the manner and within the time provided for appeals by this Act, be taken to and allowed by the circuit court of appeals independently of other appeals in the proceeding, and shall be summarily heard upon the original papers.